RECEIVERS IN BANKRUPTCY AND THE PROPOSED AMENDMENTS TO THE BANKRUPT LAW AS TO CORPORATIONS.

A feature of the present bankruptcy law which has thus far attracted no special attention, but which is of large importance, is found in the power of courts of bankruptcy to appoint receivers of the property of debtors before adjudication. This power is now freely exercised, and is likely, if the proposed amendments of the law before Congress are adopted, to be exercised much more extensively in the future.

Before considering the practical working of this procedure and the wisdom of extending it, it is necessary to refer briefly to a particular phase of bankruptcy legislation.

The present Act provides that the trustee of the estate of the bankrupt shall be vested, by operation of law, with the title of the bankrupt as of the date he is adjudged a bankrupt.[1] This is a departure from previous bankruptcy legislation as to the time of vesting title.

Under the English bankruptcy law, the rule early established was that the title of the assignee related back to the time of the act of bankruptcy upon which the adjudication was had.[2] The injustice of this rule, as applied to persons dealing with the bankrupt in good faith previous to the adjudication, is apparent, and modern legislation has sought to find some more suitable regulation regarding the time of transfer of title.

The present English statute protects payments made by or to the bankrupt, and conveyances by or to the bankrupt, and any contract, dealing or transaction by or with the bankrupt for a valuable consideration before the date of the receiving order on the part of a person having no notice of an available act of bankruptcy committed by the bankrupt before that time.[3]

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[1]Section 70 Bankrupt Law.

[2]13 Eliz. Ch. 7. See Eden Bankruptcy Laws, p. 258.

[3]Bankruptcy Act of 1883, sec. 49. See Williams on Bankruptcy, p. 171, and on the subject generally the following line of decisions, King *v.* Leith, (1787) 2 T. R. 141; Edwards *v.* Gabriel, (1862) 31 L. J. Exch. 113; Ex p. Snowball *v.* Douglas, (1872) L. R. 7 Ch. 534; Ex p. Edwards *v.* Chapman, (1884) 13 Q. B. 747.

By our Act of 1867, it was expressly provided that the assignment of the bankrupt's property to the assignee related back to the commencement of the proceedings in bankruptcy,[1] and the courts enforced this provision with considerable rigor, going to the extent of holding that payments made by a debtor to the bankrupt after proceedings had been instituted, even though without actual notice of the bankruptcy proceedings and in the usual course of business, would not relieve the person making the payment from a subsequent action by the assignee to recover the debt thus satisfied.[2] In Connor *v.* Long,[3] the doctrine was thus stated by the Supreme Court:

"The title of the bankrupt in the interval (between the filing of the petition and the assignment to the assignee) is defeasible and when the assignment is made is divested as of the date when the petition was filed. All titles derived under or through him, originating subsequent to that date, are overreached and defeated and that by force of law, without regard to the knowledge or motives of the claimant."

It was the established rule, under that statute, that the filing of the petition in bankruptcy was constructive notice to all persons, and that a subsequent conveyance or transfer by the bankrupt was a nullity and absolutely void as against the assignee[4]. Thereafter all the property rights of the debtor were *ipso facto* in abeyance until the final adjudication[5]. That Act in this particular was criticised by Judge Sharswood as "unjust and cruel."

The intention of the framers of the present Act was to escape if possible from the harshness of the earlier statutes. They meant to devise a system which should interfere as little as possible with the debtor's property before the trial and actual determination of his bankruptcy, but nevertheless they realized that cases might arise where to leave the bankrupt in the full control and disposition of his property

[1]U. S. R. S. sec. 5044.

[2]Howard *v.* Crompton, (1877) 14 Blatch. 328; Maize *v.* Manufacturers Nat. Bank, (1870) 64 Pa. St. 74, s. c. 4 N. B. R. 660.

[3](1881) 104 U. S. 228, 230.

[4]In re Gregg, (1868) 3 N. B. R. 529; In re Lake, (1872) 3 Biss. 204, s. c. 6 N. B. R. 542; Perlee *v.* Dole, (1854) 38 Me. 558; Okey *v.* Corey, (1855) 10 La. An. 502; Sicard *v.* Buffalo, N. Y. & Phila. R. R. Co., (1879) 15 Blatch. 525.

[5]Bank *v.* Sherman, (1879) 101 U. S. 403, 406; Taylor *v.* Robinson, (1884) 21 Fed. 209; In re Hussey, (1878), 2 Hask. c. c. 245; Babbitt *v.* Burgis (1873), 7 N. B. R. 561.

pending proceedings for adjudication would be to invite delay and to defeat the operation of the law. They, therefore, provided for what might be regarded as cases of emergency, by conferring upon Courts of Bankruptcy power to appoint " receivers or marshalls upon application of parties in interest, in case the Courts should find it absolutely necessary for the preservation of estates, to take charge of the property of bankrupts after the filing of the petition, until it is dismissed or the trustee is qualified."[1]

While, therefore, it was not the intention of the framers of the Act to make the title of the trustee relate back to the time of the filing of the petition by the appointment of a receiver *pendente lite* in all cases where there were assets to be preserved, yet the exigency provided for at first justified and afterwards made customary the appointment of preliminary receivers in substantially all cases and has thus restored the doctrine of relation back to the time of the filing of the petition.

From August 1, 1902, to November 12, 1902, there were filed in the Southern District of New York eighty-five petitions in involuntary bankruptcy and in seventy-one of these proceedings preliminary receivers were appointed. Probably a similar, if not a larger, proportion of appointments were made in other districts.

The system which has now come into operation is the result of the difficulty of fixing the exact point of time at which an embargo should be placed upon the property of an alleged bankrupt. The solution of the problem thus arrived at is practically to fix that time at the filing of the petition, through the *ex parte* appointment of a receiver.

We now turn to the proposed extension of the law. While the present Act does not permit a corporation to file a voluntary petition, it does permit petitions to be filed against corporations which are engaged principally in manufacturing, trading, printing, publishing or mercantile pursuits when they have been guilty of any one of the acts of bankruptcy which would justify the filing of the petition against any other debtor. But the appointment of a receiver of a corporation, either in voluntary or involuntary proceedings, is not an act of bankruptcy, and it has been

[1]Section 2 (3).

held that the appointment of a receiver of an insolvent corporation, when none of the prescribed acts of bankruptcy is charged, does not justify an interference by courts of bankruptcy with the proceedings for the liquidation by the receiver appointed by a court of competent jurisdiction, under the authority either of the State or of the United States[1].

The proposed amendments to the bankruptcy law provide that

"any corporation engaged principally in manufacturing, trading, printing, publishing, mining or mercantile pursuits shall be entitled to the benefits of this Act as a voluntary bankrupt on petition of an officer or stockholder of such corporation, duly authorized at a meeting of stockholders held for that purpose, by the vote of the majority in amount of the total stock of the corporation."

It is also provided by these amendments that it shall be an act of bankruptcy if any person or corporation, being insolvent has applied for or been put in charge of a receiver or trustee under the laws of a State or Territory or of the United States and any corporation, engaged in the businesses mentioned above may be adjudged an involuntry bankrupt, upon the petition of three creditors having provable claims amounting in the aggregate to five hundred dollars.

The proposed amendments further provide that the Court shall have the power to authorize the business of the bankrupt to be conducted for a limited period by receivers, marshals or the trustees in the best interests of the estate, and that it shall have authority to allow such officers additional compensation for such services.

These amendments are intended to subject practically all companies incorporated for gain, other than railroad, insurance and banking corporations, to the operation of the bankruptcy law in case of insolvency, and to supersede wholly the liquidation of insolvent corporations under State laws.

If this legislation takes effect, the jurisdiction of the bankruptcy courts will be vastly enlarged and business at all times of large proportions, and in times of financial disaster of untold magnitude, will be devolved upon these Courts to the exclusion of all others.

[1] In re Empire Metallic Bedstead Co. (1899) 98 Fed. 981.

It is of importance, therefore, to consider how the present system of receiverships in bankruptcy is conducted. A petition in involuntary bankruptcy, as we have said, may be filed by three creditors having provable debts to the amount of $500. The petition must be verified, but the present Act, unlike the Act of 1867, does not require that the petition be accompanied by depositions establishing the petitioner's claims against the debtor, or making proof of the facts constituting the alleged act of bankruptcy. The petition may be and often is made merely upon information and belief. Upon the filing of the petition the District Judge may, and not infrequently does, appoint a receiver without notice to the bankrupt, upon an affidavit or petition substantiating more or less fully the matters set forth in the petition for adjudication with a statement of the amount and character of the assets and of their value.

The Act requires that when a receiver is appointed a bond shall be given by the petitioning creditors conditioned for the payment to the alleged bankrupt, or his personal representative, of all costs, expenses and damages occasioned by the seizure, taking and detention of his property. The only means the Court has of determining what amount shall be required as the penalty of the bond in an involuntary proceeding is the estimate made by the petitioning creditors of the value of the debtor's property, and the amount of the bond is left entirely to the discretion of the judge.

It has been held by the Courts that a receiver appointed *pendente lite* may, by order of the Court, sell the assets of the alleged bankrupt before adjudication and before the appointment of a trustee.[1]

When one considers that the filing of a petition in bankruptcy against a person or corporation and the appointment of a receiver of the assets of the alleged bankrupt instantly destroys credit, and depreciates the value of assets, it must be apparent that in many cases, even though the debtor has been guilty of no act of bankruptcy, long before a trial can be reached and his innocence established, he may be hopelessly ruined.

The Act also permits a preliminary receiver to compel

[1] In re Becker, (1899) 98 Fed. 407; In re Styer, (1899) 98 Fed. 290; In re T. L. Kelly Dry Goods Co., (1900) 102 Fed. 747.

an examination of the bankrupt and witnesses concerning the acts, conduct and property of the bankrupt,[1] so that before adjudication the debtor is subjected to inquisition, his books and papers may be taken from his custody and a case may be prepared to support the petition, or possibly to discover some act of bankruptcy not alleged, upon which a new or amended petition may be filed.

Inasmuch as a considerable time must necessarily elapse between the filing of an involuntary petition and the first meeting of creditors, it not infrequently happens that the goods of the bankrupt, if a trader, have been sold by the receiver and the estate substantially reduced to cash before the creditors meet. It then becomes a question with creditors whether they will continue the receiver as trustee or whether they will select a new trustee. The result naturally is that in a large proportion of instances the receiver is selected as trustee because the work has been already largely performed by him.

The tendency of this system is to bring about a close connection of officials; persons who have been found efficient as receivers are naturally appointed again and again; they are continued as trustees; they become practically official liquidators; they are brought into constant and intimate relations with referees and other officials. Whatever good results may be obtained for creditors by the smooth and harmonious working of such a procedure is more than counterbalanced by the peril resulting to debtors. The danger of abuses escaping the eye even of the most watchful and painstaking judge is certain. In New York State it became necessary, after the scandals arising in the Erie Railway litigation, to pass a law prohibiting the appointment of receivers of corporations except upon notice, and subsequent legislation has still further safeguarded the appointment of such receivers by requiring that notice of the application for the appointment shall be given to the Attorney-General. Unfortunately, experience has also further warned us that when unlimited authority is conferred upon the courts, as proposed by these amendments, to allow com-

[1] In re Fixen, (1899) 96 Fed. 748.

pensation to receivers without restriction as to amount, that discretion is very likely to be abused.

These considerations are in themselves sufficient to raise a very serious question as to the wisdom of extending the present system of appointing temporary receivers in bankruptcy in United States Courts to all classes of corporations organized for purposes of gain merely upon the ground of their insolvency.

Nor is there anything to be gained by transferring to the United States District Courts the business of liquidation and dissolution of insolvent corporations.

The laws of the several States provide with great uniformity for the equitable distribution of the assets of such corporations, so as to prevent preferences among creditors, and thus the great end of bankruptcy legislation, so far as creditors are concerned, is secured.

The discharge of a corporation from its debts in bankruptcy is a novel feature of the present bankrupt law, which it is not easy to justify on principle.[1] The advocates of bankruptcy legislation have been able to defend the discharge of legal obligations by the law-making power only upon the ground of a public policy which would restore citizens burdened with debt, and, therefore, incapable of returning to active employment, once more to usefulness, but this argument has no place when applied to an artificial being like a corporation.

There never has been any attempt to subject banks, railways, insurance companies or eleemosynary corporations to the operation of bankruptcy laws. In cases of insolvency the general provisions of the statutes of the sovereignty, whether State or National, under which the corporation was organized, have been regarded as adequate for the liquidation or dissolution of such corporations.

The laws of the several States respecting insolvent corporations are not such as to require that they should be set aside and superseded by the bankrupt law for the purpose of securing the equitable or just rights of creditors. On the contrary, there are several considerations, some of which are found in the present system of appointing receiv-

[1] In re Marshall Paper Co., (1900) 102 Fed. 872; s. c. (1899) 95 Fed. 419.

ers in bankruptcy already referred to, and some of which are innate in any administration of a bankruptcy law, which render it inexpedient to subject all business corporations to the operation of the bankrupt law.

The modern method of dealing with insolvent corporations is, if possible, to preserve, reorganize and continue them. For this purpose the plastic hand of a court of equity is especially adapted. The formalities, officialism and necessary rigidity of bankruptcy proceedings are poorly qualified to produce the best results in this work.

We are not without guidance in this matter. The English bankruptcy law of 1883-90 excludes from its operation all companies registered under the Companies Act of 1862, which practically excludes all business corporations organized for purposes of trade. The winding up provisions of the Companies Act of 1862, as amended from time to time, permit the liquidation of insolvent corporations either through voluntary proceedings instituted by the corporation itself, or through involuntary proceedings in which an official liquidator is appointed. The Court is authorized to supervise the proceedings of a voluntary liquidator, and ample provision is made for reorganizations and for the transfer of the business of the embarrassed Companies to a new Company by the issuing of stocks and bonds in the mode in which reorganizations are ordinarily carried through in this country.

The English procedure thus excludes control of insolvent corporations from the bankruptcy courts and provides a special method for the liquidation of their affairs. This is analogous to the present conditions existing here where such corporations may be liquidated under the authority of State statutes.

It is true that the National Bankruptcy Law contains provisions for composition proceedings, but it is extremely doubtful whether these provisions are adequate or appropriate for the reorganization of a corporation, the affairs of which have become complicated and involved. The bankruptcy law gives no status to stockholders; it deals merely with the bankrupt and creditors. The interposition of stockholders is often of extreme importance in restoring embarrassed companies to usefulness. Of course, it cannot

be said that the reorganization of corporations cannot be accomplished through the bankruptcy court, but at best the attempt must be experimental while the facilities now afforded by courts of equity in the several States are entirely adequate and satisfactory.

Many of the proposed amendments to the bankruptcy law, now pending before Congress, are of a character to strengthen the Act and render it more efficient, but the provisions which extend the operation of the bankruptcy law to corporations, and especially the amendment which renders the appointment of a receiver an act of bankruptcy, and thus practically ousts the jurisdiction of the United States Circuit Court and all the State Courts over insolvent corporations, is, we think, open to many grave objections.

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